PRACTICAL EFFICIENCY OF THE PRESENT BANKING LAW.

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In the annual report of the Comptroller of the Currency, special attention is called to three features of our national banking system, and suggestions are made as to how Congress can improve them by legislation. These are:

First: The excessive loaning of a bank's funds to its officers and directors;

Second: The limitation of individual loans to ten per cent. of the bank's capital, which, there being no special penalty provided for its infringement, has become partially inoperative;

Third: The evil effects supposed to result from what is considered the too lax provisions of the present law, in regard to the extent to which the legal reserve of one bank can safely be represented by a deposit in another bank, instead of by cash in its vaults.

In the suggestion to correct or improve the first of these features, in regard to excessive loans to officers and directors, a very proper distinction is made between loans to executive officers and those made to directors actively engaged in other lines of business. It is recommended that loans to executive officers should not be made until after they have been submitted in writing to the directors or executive committee of the bank, and approved by a majority of them—with a fine fixed for the infraction of this rule; and, in regard to loans to directors, it is recommended that the limit of credit which shall be extended to any director may be fixed by a resolution of the Board at any regular meeting—within which the executive officers in their discretion may loan to a director without other action by the Board.

If a limit of credit has not been so fixed, an application for a loan by a director must be in writing and approved by two directors. Such a loan may be made by an executive officer, but it must be brought to the attention of the Board at its next meeting —a penalty to be provided for violation of this rule.

These recommendations are features of a bill introduced at the last session of Congress by Marriott Brosius, Chairman of the Committee on "Banking and Currency," and are commended by the Comptroller. Are they practicable?

I heartily concur in any restrictions placed upon the executive officers of a bank in making loans to themselves, and I care not how strict these are made. I would even go further. I would suggest that such loans be entirely prohibited. There is an old saying that "it takes two to make a bargain," and it is a simple business proposition that an executive officer of a bank should not be allowed to act on both sides of transactions, on one side of which he represents his own personal wants and interests, and on the other officially represents the lending bank. I am, however, not equally in accord with the recommendations in regard to restrictions on loans to directors engaged in other lines of business.

The first recommendation, "that a limit of credit be fixed for any individual director by a resolution of the Board within which the executive officers may grant loans," would, in practice, lead to a result quite different from that which it is intended to accomplish. The executive officer, being relieved by the resolution of the directors from the responsibility properly devolving upon him by virtue of his executive office, would cease to give that close scrutiny to his transactions with directors which alone can save a bank from bad debts. A fixed and steady limit of credit, whether to a director or to any other customer, involves a bad principle in banking. Steady lines of credit to directors would be made easier, and, therefore, more common. They would be ratified and confirmed by the very law proposed.

If the executive head of a bank is fit for his position, it will be more difficult for any individual director to secure from him a line of credit to which he is not entitled than it would be to get it from a Board of Directors of which he himself is a member. Directors only share the responsibility of their united action. The executive officer assumes his alone, and is directly responsible for his action to the directors.

It is the executive officer's duty to go carefully into the condition of the affairs of any one to whom he lends money, whether he be a director or not. It is his specialty to pass upon credits, and he learns how to say "No." To place upon the directors of a bank the whole responsibility of fixing the limit of any director's line of credit would only make it easier for individual directors to secure for themselves credit to which they are not entitled.

The further recommendation that, in "cases where a director's limit has not been fixed by resolution of the Board, he should make his application for a loan in writing, approved by two directors," is equally impracticable. It would only handicap an executive officer in performing his duty. It requires courage to decline a director when he makes a personal application unsupported by any stronger influence; it would call for heroic courage to decline a director a loan when approved by two other directors; and it goes without saying that any man of sufficient standing and respectability to be elected a bank director would find it an easy matter to persuade two of his friendly co-directors to approve his application for him. They would do so in perfect innocence, and no one could blame them. It is not their business to go into the affairs of their co-directors in the same way that an executive bank officer should. They would probably know the applicant as a good citizen, and a good fellow, but would not be likely to know enough about the details of his affairs to warrant them in recommending him for the credit he applies for. They might approve his application from the negative standpoint of not knowing any reason why he should not have it. The executive officer might, however, know some positive reason why he should not; and, as I have said, the approval of the application by two directors would only handicap him in his dealings with directors when they wanted more than they are entitled to.

Directors, when they become applicants for loans, should do so as individuals, on exactly the same footing as other customers. As a relief to the executive officer from the personal influence which an individual director may bring to bear upon him, he has always the full Board to fall back upon. The best men will, as a matter of course, be even more scrupulous as to their borrowings from a bank in which they act as directors than they would otherwise be. So far this has been my fortunate experience with the directors with whom I have been associated. There can be no

question that the best directors a bank can have are men actively and prominently engaged in business. This being so, there is nothing startling in the discovery that 18,534 out of a total of 28,709 directors of national banks are directly or indirectly indebted to the banks under their management. The only important questions in this connection are, how much of the bank's funds these directors have more than they are legitimately entitled to on a purely business basis, and how much more they have than would be granted to them if they were not directors. So long as human nature remains what it is, some men will take advantage of their official positions for their own aggrandizement, just as others will steal or otherwise act in bad faith. It is decidedly the exception, however, for a man to take advantage of his position to obtain a credit to which he is not entitled from a bank in which he is a director.

Bank directors will sometimes fail in business just as others do, and banks will lose by them just as they lose by others. Excessive loans will continue to be made to directors, not, however, because they are directors, but under the same old delusion under which bankers are led on to excessive loans, and ultimately to excessive losses—namely, the hazarding of more money to save a loan already in jeopardy. Excessive loans, unless they are deliberate thefts, are not made in first transactions. Bank directors as a class are among the best customers a bank has, and no urgent necessity exists for special legal discrimination against them. Some of them will turn out badly, in spite of any law that can be devised; but because the "hold-up man" goes abroad after dark to follow his nefarious occupation, it is superfluous to make a law preventing good citizens from walking on the streets after sundown. The law should be directed to the punishment of the wrong-doer, without interfering with the inherent rights of the good citizen.

The recommendation of the Comptroller for improvement in the second feature of our banking system to which he draws attention, is that after the words in Section 5200 of the Banking Act reading as follows: "Loans to any person, etc., shall at no time exceed one-tenth part of the amount of the capital stock of such association actually paid in," should be added the following: "Provided, that the restriction of this section as to the amount of total liabilities to any association of any person, or of any

company, corporation or firm, for money borrowed, shall not apply where a loan in excess of one-tenth part of the capital stock shall be less than two per cent. of the total assets of said bank at the time of making said loan. Said loan shall be at all times protected by collateral security equal to or greater in value than the excess in the amount of said loan over one-tenth of the capital stock."

It is always a dangerous thing to have any vital part of a law inoperative, or partially so. I have no doubt that the Comptroller finds difficulty in some cases in enforcing this law as it now exists.

In the development of our banking system, some banks with comparatively small capitals have grown to positions of commanding importance, have acquired large resources and accumulated large surpluses; and the law, as it now stands, would prevent them from making absolutely well-secured loans which their positions and resources fully entitle them to make. They should not, therefore, be held to a strict performance of this part of the law; but the fact remains that the Comptroller does hold other banks, not similarly situated, to a strict interpretation of it. It would, therefore, be well to change the law to meet the changed conditions, and I think the Comptroller's recommendation for an improvement in this feature of it is a good one.

The next feature, the Comptroller says, involves the fundamental principles of safe banking. It also forms, however, an important part of the national banking system itself. It is, in fact, one of the props on which the system, as it has been developed, leans. We must be careful how we interfere with it.

I think the Comptroller is inclined to exaggerate the evil results of the centralization of reserves in the large financial centres. The world's reserves are centralized in its principal financial centres. It dissipates the financial strength of a country to have its actual money resources scattered all over the country in small amounts. From an economic standpoint, it is one of the weaknesses of our national system that it requires a too wide distribution of our actual money reserves. The evolution now going on in the system will, if allowed to work itself out, mitigate the evil to which the Comptroller draws attention.

Bank consolidation, causing the formation of large banks in the central reserve cities, which carry large reserves available

when necessity calls for them, will afford strength to the system not heretofore felt. Although essential under our system, the legal reserve limit is not without its bad features. The fluctuations of the legal reserves of the associated banks of New York, watched as they are by every banker in the country, and commented upon weekly in the press dispatches, exercise entirely too much influence on the financial nerves of the country. A barometer is thus formed by which the financial weather of the country is forecast. Whenever our reserves get low, we prepare for a storm by withdrawing our balances and strengthening our cash reserves; and thus, by our own action, we increase the trouble which we should try to avert. This is an inherent weakness of our system, the ultimate remedy for which has not yet been evolved. It will, I think, come along the line of greater concentration of our cash resources, and not by their wider distribution, which will only dissipate our strength. What is wanted is cash reserves, held in the large financial centres, of sufficient magnitude to satisfy the whole country that they can get money when they need it. This, with an adequate circulating medium that will automatically expand and contract in response to the varying needs of business, will supply that confidence which every now and then under existing conditions is found to be lacking. It is largely a matter of confidence. When we know that we can get gold or legal tenders whenever we require them, we don't want them unless we actually need them; but if there is any doubt about it we want them whether we need them or not. If under our system it can be obtained, a bank currency in some degree responsive in the volume of its issue to the volume of the business done—and not, as is now the case, bearing no relation whatever to the business conditions calling for it—would be a big step toward a solution of our difficulties.

The Comptroller's recommendation is that but one-fifth instead of three-fifths of the fifteen per cent. reserve required by law of banks not reserve agents, may consist of balances due by reserve banks; and that banks in reserve cities be not allowed to continue to keep one-half of their legal reserves in the shape of balances due by their agents in central reserve cities.

On September 5th, last, the 3,304 country banks were carrying with their reserve agents $253,514,133, and the 261 banks of the twenty-seven ordinary reserve cities of the country were carry-

ing with their reserve agents in central reserve cities $151,-442,395. What portion of this amount, aggregating $404,956,528, these banks would have to withdraw to comply with the suggestion of the Comptroller, we cannot accurately determine; but that it would be a large portion is certain. To estimate that the half of it would be withdrawn, is to keep on the conservative side.

If the Comptroller held one of the positions now filled by some of his predecessors in office and himself became the executive officer of a central reserve city bank, I don't think he would suggest anything quite so radical. His expressed desire is to avoid the financial experiences through which this country has passed during the last few years, including the widespread withdrawal of currency through the country and the strain the reserve cities were subjected to in 1893, endangering the stability of the entire banking system. It does not seem to have occurred to him that the contraction which his suggestion involves would subject the banks to an experience precisely similar to that which they had in 1893, only, I believe, a greatly aggravated one; and thus he would bring about the very condition he desires to avoid.

It may be desirable thus periodically to have a practical test of the inherent strength of our system; but, to those whose hair grows prematurely grey in the process, it might seem an overdoing of the strenuous life to which, even under normal conditions, a banker is subjected. I hope Congress will defer action on the suggestions for another generation.

In the recent Presidential campaign, the successful manager of it, Mr. Hanna, as a plea for a continuance of the present administration, appealed to the people to "let well enough alone." As bankers and business men, our appeal to the present Congress should be the same: "Let well enough alone." Give us a chance, under existing laws, to develop our own resources.

With the unlimited resources at our command, if we are unhampered by unpropitious legislation, we cannot help going on to increased prosperity. It is impossible to legislate us rich, nor can we as a nation be legislated poor; but we may be hampered and retarded in our growth by ill-advised tinkering with existing laws that might shake the banking system of the country to its foundation.

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